IN THE

Supreme Court of the United States

OCTOBER TERM, 1949

No. 45

THE UNITED STATES OF AMERICA,
Petitioner,

against

HELEN W. BENEDICT and FRANK B. SMITH, as Trustees, and LELAND E. STOWELL and UNITED STATES TRUST COMPANY OF NEW YORK, as Successor Trustees under the Will of JOHN E. ANDRUS, deceased,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR RESPONDENTS

THEODORE PEARSON,
JOHN W. DRYE, JR.,
HEWITT A. CONWAY,
Counsel for Respondents.

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Preliminary Statement

Pursuant to an opinion filed on January 3, 1949, which is reported in 81 Fed. Supp. 717, the Court of Claims of the United States on January 3, 1949 adjudged and ordered that respondents should recover from petitioner income taxes paid for the fiscal year ended April 30, 1944 in the total amount of $4,962.43, together with interest as more fully provided in the Judgment (R. 12). On May 2, 1949, upon the petition of the United States, this Court granted certiorari (R. 13).

Question Presented

Was the Court of Claims correct in holding that respondents were entitled to deduct, under Section 162(a) of the Internal Revenue Code, the full amount of capital gains permanently set aside by them for charitable purposes pursuant to the trust instrument, without adjustment for the percentage limitations on capital gains contained in Section 117(b)?

Applicable Provisions of the Internal Revenue Code

"Sec. 22. Gross Income

(a) *General Definition.*—'Gross income' includes gains, profits, and income derived from * * * sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; * * *.

(f) *Determination of Gain or Loss.*—In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in section 111."

"Sec. 111. Determination of Amount of, and Recognition of, Gain or Loss.

(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113(b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized. * * *

(c) *Recognition of Gain or Loss.*—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this chapter, shall be determined under the provisions of section 112."

"Sec. 112. Recognition of Gain or Loss.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section."

"Sec. 117. Capital Gains and Losses.

(a) *Definitions.*—As used in this chapter—

* * * *

(4) *Long-Term Capital Gain.*—The term 'long-term capital gain' means gain from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such gain is taken into account in computing net income;

* * * *

(b) *Percentage Taken Into Account.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net capital gain, net capital loss, and net income:

100 per centum if the capital asset has been held for not more than 6 months;

50 per centum if the capital asset has been held for more than 6 months."

"Sec. 162. Net Income.

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

(a) There shall be allowed as a deduction (in lieu of the deduction for charitable, etc., contributions authorized by section 23(o)) any part of the gross income, without limitation, which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in section 23(o), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, * * *."

Statement of Facts

The facts as found by the Court below (R. 5-7) may be summarized as follows:

Respondents are the trustees of a testamentary trust created under the will of John E. Andrus, who died on December 26, 1934. The will establishing the trust provided that the net income of the trust should be divided into 100 parts and that 45 parts should be paid over at intervals to Surdna Foundation, Inc., a New York corporation, the balance going to named individual beneficiaries. When the trust should terminate, 45 parts of the capital of the trust were to be paid over to Surdna and the remaining 55 to the named individual beneficiaries.

Surdna Foundation, Inc. is a corporation organized exclusively for charitable purposes, payments to which are deductible as contributions under Section 23(o) of the Internal Revenue Code. Pursuant to the provisions of the trust, 45% of the income for the fiscal year ended April 30, 1944 was permanently set aside for Surdna.

For the fiscal year ended April 30, 1944, the trust had a gross income, other than gains from capital assets, of \$270,169.92 and deductions of \$29,602.19, leaving a balance of \$240,567.73, which amount was also the amount currently distributable to beneficiaries. The trust had a gross long-term capital gain of \$60,374.01, of which \$30,187.01 was taken into account in computing taxable net income. A 1942 carry-over of \$329.60 reduced this latter amount to \$29,857.41. In preparing the fiduciary return, the trustees deducted \$13,435.83, 45% of the amount of \$29,857.41, which represented Surdna's portion of said \$29,857.41. Surdna actually got 45% of the \$60,374.01. The computation made by the trustees left the amount of \$16,421.58, which they reported on the return as "Net Taxable Gain Taxable to Trustee". This amount was the net income shown by the return, upon which tax was paid.

Subsequently, the trustees filed a claim for refund of tax paid upon the net income computed as above set forth. In this claim they asserted their right to deduct as a charitable contribution 45% of the gross long-term gain of $60,374.01, rather than 45% of such gain as reduced by the 50% limitation set forth in Section 117(b) of the Internal Revenue Code.

No action having been taken on the claim by the Commissioner of Internal Revenue, the trustees brought suit in the Court of Claims. On January 3, 1949, that Court held that the trust was entitled to deduct, as a charitable contribution, the entire amount of the capital gains set aside for charity in 1944, unaffected by the 50% limitation and rendered judgment accordingly in favor of the trustees (R. 7-11).

Summary of Argument

The trust realized a profit of $60,000 on the sale of capital assets and, as required by the will, set aside 45% thereof, or $27,000, for a charitable foundation. As the trust had held the capital assets more than six months, only 50% of the total gain (i.e. $30,000) was "taken into account in computing *net* income", under Section 117(b) of the Internal Revenue Code.

The trust is entitled to a charitable deduction of the entire $27,000 set aside for charity, and not merely $13,500 thereof as the Government contends (the foundation's percentage, 45%, of the $30,000 gain taken into account). Section 162(a) permits a trust to deduct "any part of the *gross* income" which it sets aside for charity. Section 22(a) defines "gross income" as including gain, and other Sections define "gain" as the entire difference between cost and the amount realized.

Although special tax treatment of capital gains had been granted by statute since 1921, it was in the 1934 Act that the revenue laws adopted the device of providing that only specified percentages of a capital gain should be taken into

account in computing net income. The change was made in order to extend the benefits of the special tax treatment of capital gains to taxpayers in low brackets. There is absolutely no evidence that the device was also intended to reduce the charitable deductions of trusts. These continued, as during the previous sixteen years, to be for "any part of the *gross* income".

Here the Government is seeking to apply Section 162(a) as though the deduction was for "any part of the *net* income". So drastic a change—reducing allowable charitable deductions of trusts by 50% or more—cannot be derived by any supposed implication from a relief provision designed to cut down taxable net income in the case of capital gains.

This Court, as heretofore, should reject this attempt to use an amendment of other provisions of the law to reduce the amount of allowable charitable deductions, as inconsistent with the doctrine that tax exemptions in favor of charity should be liberally construed. *Helvering* v. *Bliss*, 293 U. S. 144 (1934); *United States* v. *Pleasants*, 305 U. S. 357 (1939); cf. *Old Colony Trust Co.* v. *Commissioner*, 301 U. S. 379 (1937).

ARGUMENT

The Statutory Provisions and Their History

Beginning with the Revenue Act of 1918 and continuing up to the present time, Congress has consistently granted non-corporate taxpayers two different types of deduction for charitable contributions.* In the case of individuals

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* For the charitable deduction for individuals, see the Revenue Acts of 1918 and 1921, Section 214(a)(11), the Revenue Acts of 1924 and 1926, Section 214(a)(10), the Revenue Acts of 1928 and 1932, Section 23(a)(2), and the Revenue Acts of 1934, 1936 and 1938 and the Internal Revenue Code, Section 23(o). For the charitable deduction allowed fiduciaries, see the Revenue Acts of 1918, 1921, 1924, and 1926, Section 219(b), and the Revenue Act of 1928 and all succeeding Revenue Acts, including the Internal Revenue Code, Section 162(a).

the deduction is limited to 15% of net (now adjusted gross) income, but in the case of fiduciaries the deduction is any part of the gross income. The statute allowing the latter deduction, Section 162(a) of the Internal Revenue Code, contains apt and carefully chosen language designed to achieve the end of granting trusts an unfettered allowance for charitable contributions. It states that in computing the net income of an estate or trust "there shall be allowed as a deduction (*in lieu of* the deduction for charitable, etc., contributions authorized by section 23(o)) *any part* of the gross income, *without limitation*, which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for" charity. By using the three phrases we have italicized above, namely "in lieu of", "any part" and "without limitation", the legislature displayed a clear intent to ensure the broadest conceivable allowance.

The trust in this case realized a profit of $60,374.01 on the sale of capital assets and, as required by the will, permanently set aside 45% thereof, or $27,168.31, for Surdna Foundation. The trust contends that in computing its net income it is entitled to a deduction under Section 162(a) for the full amount thus set aside for charity.

The trust had held the capital assets more than six months, so that under Section 117(b) of the Code only 50% of the total gain was taken into account in computing net income. This 50% (after a reduction for a small carry-over) amounted to $29,857.41. The Government contends that the trust's charitable deduction must be confined to 45% of the latter amount, or $13,435.83 (Br., p. 11).

The Court of Claims upheld the trust's contention, viz. that under Section 162(a) the trust was entitled to deduct the entire $27,168.31 set aside.

Section 162(a), as already indicated, allows a trust a charitable deduction for "any part of the gross income". "Gross income" is defined by Section 22(a) to include "gains * * * derived from * * * sales, or dealings in property * * *". The method of determining and recognizing

gains and losses is set out in Section 22(f) and portions of Sections 111 and 112, as follows:

> "In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in section 111." (Section 22(f))

> "The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113(b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized." (Section 111(a))

> "In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this chapter, shall be determined under the provisions of section 112." (Section 111(c))

> "Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized except as hereinafter provided in this section." (Section 112(a))

In other words, "gross income" includes "gains", and a "gain" is the full difference between cost and the amount realized, nothing less. Accordingly, when Section 162(a) allows a trust a deduction for "any part of the gross income" set aside for charity, the deduction will include any part, so set aside, of the entire profit realized on a sale of trust property.

The Government's only ground for arguing against such a deduction here is that the profit was on a capital asset held more than six months, so that under Section 117(b) only 50% of the gain was required to be taken into account in computing net income. If the profit had been on an ordinary asset, or if the capital asset had been held for less than six months (so that 100% of the gain was taken into account), then the Government would obviously agree that the full deduction here claimed was proper.

The statutory language on which the Government bases its entire case is thus Section 117(b), which requires that in the case of a taxpayer other than a corporation

> "only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net capital gain, net capital loss, and net income:
>
> 100 per centum if the capital asset has been held for not more than 6 months;
>
> 50 per centum if the capital asset has been held for more than 6 months."

It will be seen at once that Congress is not here redefining "gain", "loss" or "gross income", which have already been fully defined in Sections 111(a) and 22(a),—nor indeed making any definitions at all. Congress is here providing special tax treatment for gains and losses on capital assets held for more than 6 months, and to that end is specifying how gains and losses of this type shall be taken into account in computing *net* capital gain, *net* capital loss, and *net* income.

It is therefore clear, we believe, that Section 117(b) has no effect whatever on the trust's charitable deduction here. The trust's gross income from the sale of capital assets is the entire $60,374.01 profit which it realized thereon. Its deduction under Section 162(a) is the entire part thereof which it set aside for charity, viz. $27,168.31. The fact that Section 117(b) requires taking only $29,857.41 of the gain into account in computing net income is immaterial.

The Government's position is that the 50% of the capital gain which is taken into account in computing net income is "the taxable capital gain", and that the other half "is excluded from gross income" and does not even constitute "taxable income" (Br. p. 11).

Thus the narrow question between the parties is whether Section 117(b) has any effect on Section 162(a), either through the definition of "gross income" in Section 22(a) or otherwise. To determine the purpose and effect of the

capital gain and charitable deduction provisions, let us trace their development in the law.

In the Revenue Acts of 1913 and 1916 there was no provision for an income tax deduction for charitable contributions by either an individual or a trust. By an amendment in the Act of October 3, 1917, an individual was allowed a deduction for such contributions up to 15% of his net income; since, under the 1916 Act, the income of a trust was to be computed with the same deductions as that of an individual, the 1917 amendment thus also gave trusts a charitable deduction for 15% of their net income.

In the Revenue Act of 1918 Congress made a significant change:—it continued the individual's deduction at 15% of net, but changed the trust's deduction from 15% of net to "any part of the gross income." Section 219(b) of the 1918 Act, embodying this new deduction for trusts, is the general prototype of Section 162(a) of the Code. The words "without limitation" were added by the 1921 Act, and in the 1924 Act were shifted in position, with a shift also of the "in lieu of" clause. No further changes have been made to date.

There was no special treatment for capital gains and losses until the Revenue Act of 1921, which provided for a flat 12½% tax on gains on capital assets held over two years. (It will be noted that this was the same Act which broadened the charitable deduction for trusts by inserting "without limitation".) Changes were made in the 1924 Act, such as that capital losses could be used to reduce the total tax only at the special 12½% rate. In all of the Acts through 1932, however, the relief from surtax rates on long-term gains, and the protection of the revenue from wiping out taxes on surtax income with long-term losses, was still effected solely by the special 12½% rate of tax and not by taking only a specified percentage of the gain or loss into account.

Thus if the present case had arisen at any time up to and including 1933, there could have been no question but that the charitable deduction would have been allowed on

any part of the entire profit on the sale of capital assets, because on the face of the statutes during those years the capital gain rate was applied to every dollar of capital gain. At one time the Bureau tried to prevent the taking of any charitable deduction at all from capital gain (in the case of an individual, under the 1928 Act), but this error was corrected in *Helvering* v. *Bliss,* 293 U. S. 144 (1934).

When the "taken into account" device was first adopted in the 1934 Act, what was its purpose? Is there even a scintilla of evidence that one of its purposes was to reduce the charitable deduction of any part of the entire capital gain, to which trusts had then been entitled for sixteen years?

The House Report on the 1934 bill (H. Rep. No. 704, 73d Cong., 2d Sess.; 1939-1 Cum. Bul. (Part 2) 554, 561-2), in its "general description of the major changes proposed", introduced the subject of capital gains and losses as follows:

> "Our present system has the following defects:
>
> First. It produces an unstable revenue—large receipts in prosperous years, low receipts in depression years.
>
> Second. In many instances, the capital-gains tax is imposed on the mere increase in monetary value resulting from the depreciation of the dollar instead of on a real increase in value.
>
> Third. Taxpayers take their losses within the 2-year period and get full benefit therefrom, and delay taking gains until the 2-year period has expired, thereby reducing their taxes.
>
> Fourth. The relief afforded in the case of transactions of more than two years is inequitable. It gives relief only to the larger taxpayers with net incomes of over $16,000.
>
> Fifth. In some instances, normal business transactions are still prevented on account of the tax.
>
> * * * * *

Your committee, however, has been unable to reach the conclusion that we should adopt the British system. It is deemed wiser to attempt a step in this direction without letting capital gains go entirely untaxed. Your committee recommends the following plan:

First. [*] To measure the gain or loss from the sale of property by an individual according to the length of time he has held the property, only the following percentages of the recognized gain or loss are taken into account for tax purposes:

* * * * *

It is believed that the adoption of this plan (see section 117 of the bill) will result in much greater stability in revenue, will give all taxpayers equal treatment, will encourage normal business transactions, and will yield substantially greater revenue. The method proposed is safe from a revenue standpoint, inasmuch as capital losses can not be used to reduce ordinary income, while gains are taxed in full or in part in proportion to the time for which the property has been held. The existing method which has been in force since 1921 can be defended only on the ground of expediency."

The Senate Report on the bill (S. Rep. No. 558, 73d Cong., 2d Sess.; *idem.* 586, 594-5) quotes the House "general statement" in full and "concurs in the general features of the plan". It adds another even more drastic bracket (30% where the asset has been held over 10 years), makes certain other changes, and then concludes:

". . . The changes made are either to prevent tax avoidance or to bring about greater equity. No consequential amount of revenue is lost by these

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* The second paragraph on this page is the one quoted on page 20 of the Government's brief. As the full context shows, the phrase "for tax purposes" means for purposes of the capital gains tax, and not for purposes of charitable deductions or for determining gross income generally, as the Government would imply. Note, for example, the loose use of "property" in the same sentence; obviously this refers only to capital assets, and not to property generally.

changes. It should be noted that all persons other than corporations are affected by the percentage brackets, including individuals, partnerships, and trusts . . ."

If anything more were needed to show that nothing was further from the minds of the legislators than reducing the charitable deduction of Section 162(a), or changing the inclusion in gross income of the entire amount of capital gains, it can be found in the detailed description of the proposed new capital gains provisions in the House Report (*idem.* 577-8):

> "The following propositions are essential to the consideration of the new treatment:
>
> 1. The determination of the amount of gain or loss from each sale or exchange of property, the recognition of such gain or loss, and the basis for determining gain and loss, are all provided for in sections 111, 112, and 113 of the bill. These sections correspond to the same numbered sections of existing law.
>
> 2. Section 117 of the bill deals with the manner of taking into account in computing net income these gains and losses which have been determined under section 111 and have been recognized under section 112."

The detailed description then concludes with an illustration, the summarizing sentences of which are quoted on page 21 of the Government's brief. Here again, however, the Government omits the portions of the Report which are really significant for present purposes,—i. e., the column headings which describe the data for the particular example given:

Gain recognized under Sec. 112.	Loss recognized under Sec. 112.	Time held.	Per cent applicable.	Gain taken into account under Sec. 117.	Loss taken into account under Sec. 117."

Plainly the Committee considered that the proposed amendments left unaffected the provisions defining gain to which we have previously referred, culminating in Section 112; also, that the effect of "taken into account" was a matter under Section 117 which did not relate back to either Section 112 or Section 22(a).

It seems clear, we believe, that in enacting Section 117 of the 1934 Act there was absolutely no intention whatever to reduce the charitable deductions of a trust under Section 162(a), or otherwise to affect the practice of 16 years' standing that the entire amount of capital gains constitutes gross income under Section 22(a). If, as the Government must contend, Congress in 1934 really wanted to make this reduction, it would have been a simple matter to express such an intention,—either by changing "gross" to "net" in Section 162(a), or by providing an appropriate exception, exclusion or exemption (for the part of capital gain not taken into account) in any one of Sections 22(a), 22(b), 22(f), 111 or 116. To impute an intention to cut a trust's charitable donations by anything from 20% to 70%, is indeed too drastic a change in policy to be left to the doubtful, technical and hidden implication for which the Government contends. Yet changing "gross" to "net" in Section 162(a) is just exactly what the Government is seeking. As the Court of Claims here said (R. 11):

> "We cannot escape the conclusion that the above holding limits the deduction for charitable contributions ~~in part to~~ net income."

It is interesting to note that the "taken into account" device first adopted in the 1934 Act, was adopted as a complete substitute for the special low tax on capital gains which had been in effect since the 1921 Act. In the *Bliss* case, *supra,* which involved the capital gains provision of the 1928 Act, this Court said that this provision "prescribes merely a method" for segregating a portion of the income for taxation at a special rate, and that nothing therein "in anywise alters the right of the taxpayer to

take the deduction in accordance with" the charitable deduction section. If applying a $12\frac{1}{2}\%$ capital gain rate to 100% of a capital gain did not affect the allowance of a charitable deduction, can there be any possible reason why applying a surtax rate to 50% of a capital gain under present law would affect the amount of the charitable deduction? We submit that the "taken into account" device is also "merely a method", and should be held immaterial as in the *Bliss* case. Obviously the reason for this new device was to permit the benefits of capital gains relief to enure to taxpayers in the lower brackets, and to provide convenient mechanics for gradually scaling down the tax on gains (and the tax saving from losses) in accordance with the five different holding periods.

The similarity in purpose, but difference in method, of the treatment of capital gains and losses before and after 1934 serves to point out the fallacy of the basic assumption on which the Government's entire brief is written. The Government assumes that when a man holds a capital asset for the required time and then sells it at a profit, he is not taxed on the entire profit. For example, under present law, if a man in the 25% normal and surtax bracket holds a capital asset for more than six months and sells it at a profit of $100, he computes his tax on the profit by multiplying $100 first by the 50% limitation and then by his 25% bracket (making a tax of $12.50). Under the pre-1934 law he computed his tax by multiplying $100 directly by the $12\frac{1}{2}\%$ capital gain tax rate (making a tax of $12.50). Can it be said in either case that the entire $100 profit is not taxed, or is not taxable income? In the 1934 Act Congress was not engaged in *exempting* income from taxation, or in providing *exclusions* from gross income. If it had been, Congress would have added another exclusion and exemption in Section 22(b) or Section 116. Obviously all that Congress was doing was to perpetuate, in a slightly different form, the existing favorable treatment of capital gains, the entire amounts of which continued to be regarded as taxable income.

We have dealt at length with the purpose and effect of the 1934 amendment of Section 117 because it was there that Congress first adopted the "taken into account" device which is the sole basis of the Government's case. The device has been retained ever since, appearing now in Section 117(b) of the Code. The Section has been amended at various times, including the addition in the 1938 Act of the alternative tax, so that since 1938 there has been a combination of the pure taken-into-account method (as in the 1934-1936 Acts) with the pure low rate capital gain tax (as in the 1921-1932 Acts).

Through all these changes, however, the Committee reports on the subsequent Acts—like those above quoted on the 1934 Act—have never even suggested that either the "taken into account" device or Section 117(b) had the purpose or effect which the Government here attributes to them, viz. to reduce the charitable deduction under Section 162(a) to which a trust would otherwise clearly be entitled.*

The Judgment of Congress that the General Welfare Would be Better Promoted by Encouraging Donations to Charity than by Protecting the Revenue

By the 1917 Act, as we have seen, Congress granted to both individuals and trusts a charitable deduction of 15% of net income. The deduction for individuals has remained the same, but by the 1918 Act Congress changed the charitable deduction for trusts to be for "any part of the gross income", and this provision has now stood constant on the books for 30 years and through more than a dozen major revisions of the revenue laws.

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* On page 21 of its brief, the Government quotes a sentence from S. Rep. No. 885, 78th Cong., 2d Sess. (1944 Cum. Bul. 858, 879), but this deals with technical amendments to Sections 117(a) and 117(d) to provide for the use of "adjusted gross income" in the case of Supplement T taxpayers instead of "net income".

The sharp distinction between the two mandates has been noted and enforced by this Court, as in *Old Colony Trust Co.* v. *Commissioner*, 301 U. S. 379 (1937), where it was said:

> "Section 23n limits deductible contributions to 15% of net income. Section 162a permits them to the full extent of gross income. This language should be construed with the view of carrying out the purpose of Congress—evidently the encouragement of donations by trust estates."

Thus Congress has decided to let trusts wipe out their income taxes by giving all their income to charity. Once this social judgment was reached, Congress might well have expressed it by granting trusts a deduction for "any part of the *net* income" (in which case, of course, the present lawsuit would never have been even started). But Congress was apparently not satisfied to leave even the least uncertainty as to the broad scope of its policy, and instead allowed the deduction to trusts for "any part of the *gross* income".

The prime difference between net income and gross is deductions, so that when Congress permitted deduction for charity of the entire gross, Congress necessarily contemplated that this deduction might well be in addition to the ordinary types of deductions which would otherwise reduce the gross to net. This was the stature of the legislative decision,—that deduction of any part of gross income was permitted even though this might sanction double deductions. The propriety of a double deduction when authorized by Congress was recognized in *United States* v. *Pleasants*, 305 U. S. 357 (1939), where this Court upheld an individual's right to a charitable deduction of 15% of his net income, determined without reference to his net capital losses; the Government argued that the taxpayer had no "net income" because his net capital losses exceeded his ordinary income, but the Court sustained the deduction even though under the capital gains tax then in

effect his tax on ordinary income was to be reduced by $12\frac{1}{2}\%$ of his net capital losses.

In the present case, the effect of double deduction on which the Government elaborates (Br., pp. 32-35) is the inescapable consequence of what Congress intended,—namely, the ignoring of half of the capital gain under Section 117(b), which is allowed to all taxpayers, and in addition a deduction of such part of the entire capital gain as a trust sets aside for charity under Section 162(a).* Similarly as to the Government's complaint that the double deduction may ultimately result in incidental benefits to some individual beneficiaries (Br., pp. 29-32):— Congress certainly knew it to be common practice for the creator of a trust to name both charities and individuals as beneficiaries of the same trust, but this has not deterred Congress from leaving Section 162(a) intact, even for the fifteen years since the "taken into account" device was first used in the law.

In the light of the choice between favoring charity and protecting the revenue which Congress has already made, any such fringe imperfections should not induce the Court to ignore or distort the plain language of the statute. Rather, they should yield to the doctrine that a provision exempting income devoted to charity should be liberally construed.

In *Helvering* v. *Bliss*, supra, the Commissioner sought to limit an individual's deductions for charitable contributions to 15% of his ordinary net income exclusive of gains

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* So-called "double credits" are by no means unprecedented in other fields as well. In *Helvering* v. *Sabine Transportation Co.*, 318 U. S. 306 (1943), this Court allowed a corporation, which had issued notes in payment of a dividend declared in 1937 and which had received a dividends-paid credit in that year, another credit when it redeemed the notes in 1938. The Bureau regulations forbidding this "double credit" were condemned by the Court because "they are in the teeth of the unambiguous mandate of the statute, are contradictory of its plain terms, and amount to an attempt to legislate".

from the sale of capital assets. In holding that no such limitation could be imposed and that contributions could be deducted to the extent of 15% of net income from all sources, this Court said:

> "The scheme of all the Revenue Acts since that of 1916 has been to sweep all income of every sort, including capital gains, into what is denominated gross income and to authorize certain deductions therefrom in order to arrive at net income,—the base for calculation of the tax. * * *
>
> "Commencing with the Revenue Act of 1921 Congress, in order to encourage realization of profits on capital assets, saw fit to relieve gain thus derived of the heavy surtaxes then applicable, and to permit the payment of tax at a flat rate of 12½ per cent. on so much of the taxpayer's income as represented the net gain from capital transactions. * * *
>
> "* * * In extending this relief to taxpayers, Congress might have modified the privilege theretofore existing with respect to charitable contributions, by directing that they should be deducted solely from capital net gain or should be apportioned and deducted ratably from ordinary net income and from capital gain. The Acts, however, evince no such purpose. * * *
>
> "By the express words of § 23(n) [now (o)] charitable contributions are to be deducted to ascertain net income as defined in § 21; and nothing in § 101 [now 117], which prescribes merely a method for segregating a portion of that net income for taxation at a special rate, in any wise alters the right of the taxpayer to take the deduction in accordance with § 23(n).
>
> "If the meaning of the Act were doubtful, we should still reach the same conclusion. The exemption of income devoted to charity and the reduction of the rate of tax on capital gains were liberalizations of the law in the taxpayer's favor, were begotten from motives of public policy, and are not to be narrowly construed. Nor should the reduction in the rate of tax on capital gain * * * be held to

> circumscribe the privilege granted in the earlier Acts, and retained in later ones, with respect to charitable contributions, unless that result be plainly required by the language used. * * * the statutes if read as written lead to a contrary result."

In now arguing against full allowance of the deduction under Section 162(a), the Government has concerned itself solely with the tax benefit which would thereby result to the trust. The sole concern of Congress, however, was how much money the trust has set aside for charity and how much the trust has thereby lightened the burdens of government. The measure selected for the deduction is the amount given (the gross income), not the amount that would have been taxable (the net income). Here the trust has set aside $60,000 for charity, but the Government is taxing the trust as though it had set aside only $30,000. As the $60,000 was set aside, it can make no difference to the Government or anyone else whether it came from long-term gain, short-term gain, or ordinary income, and the deduction should be fully allowed in either event. The officials of Government charged with protecting the revenue are really complaining of the Congressional policy of favoring private gifts to charities. If they dislike a deduction that is clearly authorized, however, they should make their application to the body that created it.

Some Points in Reply

We believe that we have already dealt with those matters in the Government's brief which go to the substance of the issue between the parties. A few of the others, however, we cannot allow to pass unnoticed.

The Government devotes eight pages (11-19) to the proposition that the trust's profit on the sale of capital assets held more than six months is not gross income. The Government turns its back on the straightforward definition of *entire gain* as gross income in Sections 22(a) and (f), 111, 112 ~~and 113~~ above quoted, and stands on an alleged

vacuum said to have been left by Section 117(b) in directing that only 50% of the gain shall be taken into account in computing *net income*. We had thought this direction clear, but if the Government finds it otherwise we fear the trouble must be that the Government is looking for a perfectionist symmetry that does not appear in revenue acts or any other document born in the mind of man. There is a capital loss carry-over in Section 117(e), for example, which seems to perform its task adequately, yet it does not "fit precisely into the pattern of Sections 21-23" and is not even mentioned in them.

The Government's discussion of "administrative construction" (pp. 21-25) serves only to indicate that the Government considers administrative construction essential to its case, and that such a construction is lacking. The only evidence adduced is a discredited G.C.M., an example in a regulation promulgated during the taxable year here involved, and an income tax return form said to prove inclusion in "taxable gross income", in which not even the words "gross income" appear. The Government admits that the upper part of page one of the return is headed only "income". Small wonder,—because, of the ten items there listed, five are net of deductions and could even be loss figures. The return proves nothing.

Here again, as throughout the brief, we find the Government talking about "*taxable* gross income" (or "*taxable* capital gain"), and yet seeking to convey the impression that this conveniently guarded phrase covers everything that is included in the "gross income" of Sections 22(a) and 162(a). To characterize the 50% of a capital gain which is taken into account in computing net income as "taxable gross income", necessarily implies that the other 50% is "non-taxable gross income". Yet such a characterization of either half also admits that both halves are constituents of gross income. The statute, of course, knows no such distinction, and speaks only in terms of "gross income". It is hard to see how the Government advances the discussion by dealing in non-existent distinctions, particu-

larly when the terms coined seem to admit the point which they are intended to disprove.

The Government has little to say about the cases (pp. 25-28). As regards *Commissioner* v. *Central Hanover B. & T. Co.*, 163 Fed. 2d 208 (C. A. 2d 1947), cert. den. *sub nom. Trust of Andrus* v. *Commissioner*, 332 U. S. 830, we submit, with all deference, that the reasoning and conclusion of the Court of Claims and The Tax Court of the United States are sound, and that the decision of the Court of Appeals is not justified. Further, we should like to record our understanding that the Court of Appeals did not have before it the full statutory history to guide it. When that case was decided below (7 T. C. 573 (1946)), the Tax Court held for the taxpayer, and found no difficulty in distinguishing *Maloy* v. *Commissioner*, 45 B. T. A. 1104 (1941), on which the Government places such reliance here, and *Grey* v. *Commissioner*, 41 B. T. A. 234 (1940), affirmed, 118 Fed. 2d 153 (C. C. A. 7th 1941). As regards *Lockhart* v. *Commissioner*, 1 T. C. 804 (1943), we feel that the Court's language is worth quoting:

> "* * * a taxpayer upon making a sale is required to report the entire gain therefrom in his return. Having done this, the taxpayer is then accorded the benefit of section 117, which provides in effect that only a percentage of the gain thus returned need be included in computing net income if the asset has been held for a specified period. In our opinion, however, this cannot be construed to mean that the clear requirement of reporting or returning the entire gain has been waived."

Conclusion

The judgment of the Court of Claims should be affirmed.

Respectfully submitted,

THEODORE PEARSON,
JOHN W. DRYE, JR.,
HEWITT A. CONWAY,
Counsel for Respondents.